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THE IRS TEA PARTY CONTROVERSY AND ADMINISTRATIVE DISCRETION

Lily Kahng[†]

The Internal Revenue Service (IRS) has no choice but to exercise discretion in administering the tax law. It oversees a vast system that affects nearly everyone. The law is often hideously complex¹ and sometimes requires the IRS to draw impossibly fine lines.² The IRS must also make choices about how to allocate its limited resources when interpreting, applying, and enforcing the law. To perform its Augean task with constrained resources, the IRS must be allowed to exercise discretion.

Having accorded the IRS some amount of discretion, we must also try to promote the fair and efficient exercise of such discretion, which we do in a variety of ways. When the IRS issues rules and regulations under the Administrative Procedure Act (APA), the APA provides for transparency and public participation in the rulemaking process, and the courts provide additional assurance that those rules faithfully implement the tax laws.³ But the IRS's discretion is not limited to APA rulemaking; the IRS also exercises discretion informally in myriad ways. For example, it decides which areas of tax law in which to issue regulations or other guidance, how to allocate enforcement efforts among various activities or groups, and whether

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¹ See NAT'L TAXPAYER ADVOCATE, 2012 ANNUAL REPORT TO CONGRESS 3 (2012) (identifying complexity as the most serious problem facing taxpayers and the IRS).

² See David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1627, 1627–49 (1999).

³ See generally PETER L. STRAUSS, TODD D. RAKOFF & CYNTHIA R. FARINA, ADMINISTRATIVE LAW: CASES AND COMMENTS 238–76, 902–1098 (rev. 10th ed. 2003) (describing the APA rulemaking process, the legal effect of administrative regulations, and the courts' involvement). The IRS is not always as compliant with the APA as it should be. See Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 NOTRE DAME L. REV. 1727 (2007) [hereinafter Hickman, *Coloring*]. Moreover, the IRS issues not only APA rules but also more informal guidance such as revenue rulings, revenue procedures, and temporary regulations whose treatment under the APA is unclear. See Kristin E. Hickman, *Unpacking the Force of Law*, 66 VAND. L. REV. 465, 472–509 (2013) [hereinafter Hickman, *Unpacking*].

to litigate or appeal specific issues.⁴ The exercise of discretion in these informal ways is subject to oversight by congressionally created bodies such as the U.S. Treasury Inspector General for Tax Administration (TIGTA), the Taxpayer Advocate Service and the U.S. Treasury IRS Oversight Board, and congressional committees such as the House Committee on Government Oversight and Reform, and the House Ways and Means Subcommittee on Oversight.

The recent Tea Party controversy presents a case study in which to examine the IRS's informal exercise of discretion and observe the operation of oversight mechanisms. As is well known, the controversy erupted when TIGTA issued a report finding that IRS employees in the Cincinnati office had targeted certain organizations' applications for tax-exempt status for heightened scrutiny. In particular, the employees singled out groups with "Tea Party" or "Patriot" in their names.⁵ A media firestorm ensued with fevered speculation about a hidden political agenda extending all the way to the White House.⁶ President Obama fired the acting IRS Commissioner.⁷ Various congressional committees held hearings.⁸ The FBI launched a criminal investigation of the matter.⁹

A complete picture of the controversy has yet to emerge, but as of the writing of this Essay, it appears that the worst suspicions about political bias are unfounded. Thus far, there is no evidence of

⁴ See generally Jerry L. Mashaw, *Prodelegation: Why Administrators Should Make Political Decisions*, 1 J.L. ECON. & ORG. 81, 96–97 (1985) (observing that the exercise of administrative discretion includes such nonsubstantive criteria as determining and prioritizing the regulatory agenda, setting priorities for enforcement, and formulating rules and procedures for fact finding in order to apply legal rules).

⁵ See TREAS. INSPECTOR GEN. FOR TAX ADMIN., INAPPROPRIATE CRITERIA WERE USED TO IDENTIFY TAX-EXEMPT APPLICATIONS FOR REVIEW (2013) [hereinafter TIGTA REPORT].

⁶ See, e.g., James Taranto, *Nobody's Laughing Now: How Pervasive Is the Obama IRS Scandal?*, WALL ST. J. (May 13, 2013), http://online.wsj.com/article/SB10001424127887323716304578481112854394652.html?mod=djemBestOfTheWeb_h. For a day-by-day aggregation of mainstream media items related to the "Tea Party scandal," including many of the scandalmongering sort, see Paul Caron, *The IRS Scandal, Day 75*, TAXPROF BLOG (July 23, 2013), http://taxprof.typepad.com/taxprof_blog/2013/07/the-irs-16.html.

⁷ See Rebekah Metzler, *Obama Fires IRS Chief in Wake of Scandal*, U.S. NEWS & WORLD REP. (May 15, 2013), <http://www.usnews.com/news/articles/2013/05/15/obama-fires-irs-chief-in-wake-of-scandal-obama-fires-top-irs-official-in-wake-of-scandal>.

⁸ At least five committees held hearings, including the Senate Finance Committee, the House Ways and Means Committee, the House Committee on Oversight and Government Reform, and the House Appropriations Subcommittee on Financial Services and General Government. See Josh Hicks, *Five and Counting: Yet Another IRS Hearing*, WASH. POST (June 4, 2013, 7:00 AM), <http://www.washingtonpost.com/blogs/federal-eye/wp/2013/06/04/five-and-counting-yet-another-irs-hearing/>.

⁹ See Kevin Johnson & Gregory Korte, *FBI to Investigate Tea Party Tax Affair*, USA TODAY (May 14, 2013, 4:57 PM), <http://www.usatoday.com/story/news/politics/2013/05/14/irs-tea-party-investigation/2158899/>.

intentional wrongdoing by IRS personnel or White House involvement in the handling of the applications.¹⁰ The TIGTA Report that prompted the controversy has been criticized as sloppy and incomplete.¹¹ It has since come to light that the IRS targeted conservative political groups, liberal political groups, and a variety of other groups for heightened scrutiny, although the TIGTA Report omitted these facts.¹² Congressional hearings have taken on the air of a circus sideshow.¹³ The *Washington Post* issued a stern admonition to politicians for “irresponsibly and repeatedly implying that a broad political conspiracy to punish President Obama’s enemies was finally becoming visible, despite the fact that there was no evidence for that conclusion and that bureaucratic bungling was a more likely explanation,”¹⁴ while more self-reflective members of the media

¹⁰ See Sam Stein, *Dan Pfeiffer: IRS Scandal Allegations Were ‘Completely False’*, HUFFINGTON POST (July 31, 2013, 12:20 PM), http://www.huffingtonpost.com/2013/07/31/dan-pfeiffer-irs_n_3682755.html; DANIEL WERFEL, INTERNAL REVENUE SERV., CHARTING A PATH FORWARD AT THE IRS: INITIAL ASSESSMENT AND PLAN OF ACTION 6, 8 (2013), available at <http://www.irs.gov/pub/newsroom/Initial%20Assessment%20and%20Plan%20of%20Action.pdf>.

¹¹ See Sam Stein, *IRS Scandal Hearings Put Inspector General in the Spotlight*, HUFFINGTON POST (July 17, 2013, 2:24 PM), http://www.huffingtonpost.com/2013/07/17/irs-scandal_n_3611460.html; Martin A. Sullivan, *News Analysis: Substantial Minority of Scrutinized EOs Were Not Conservative*, TAXANALYSTS (May 30, 2013), <http://www.taxanalysts.com/www/features.nsf/Articles/D2A6C735EAF7A9085257B7B004C0D90>; Martin A. Sullivan, *TIGTA Report Implies a Lot, Proves Little, About Bias at the IRS*, THE TAX ANALYSTS BLOG (May 28, 2013, 7:53 PM), <http://www.taxanalysts.com/taxcom/taxblog.nsf/Permalink/MSUN-985RGV?OpenDocument>.

¹² See Letter from J. Russell George, Inspector Gen. for Tax Admin., Dep’t of the Treasury, to Rep. Sander M. Levin, Ranking Member, Comm. on Ways and Means (June 26, 2013), available at <http://oversight.house.gov/wp-content/uploads/2013/06/TIGTA-Final-Response-to-Rep-Levin-6-26-13.pdf>.

¹³ See, e.g., Rebekah Metzler, *Democrats Accuse Rep. Darrell Issa of McCarthyism During Panel Vote on Lerner*, U.S. News & World Rep. (June 28, 2013), <http://www.usnews.com/news/articles/2013/06/28/democrats-accuse-rep-darrell-issa-of-mccarthyism-during-panel-vote-on-lerner>. Circus ringmaster Darrell Issa’s relentless attacks on the IRS and willful ignorance of any facts that might undermine his witch hunt have been truly impressive. See Letter from Rep. Elijah E. Cummings, Ranking Minority Member, Comm. on Oversight and Gov’t Reform, to Rep. Darrell E. Issa, Chairman, Comm. on Oversight and Gov’t Reform (July 17, 2013), available at <http://democrats.oversight.house.gov/CummingsToIssa071713.pdf> (accusing Representative Issa of creating a “skewed account based on partial, incomplete, and cherry-picked information while disregarding key evidence that contradicts your political narrative”).

¹⁴ Editorial, *The IRS Plot Thickens*, WASH. POST (June 28, 2013), http://www.washingtonpost.com/opinions/the-irs-plot-thickens/2013/06/28/8f813a06-df72-11e2-b94a-452948b95ca8_story.html. For a different perspective, see *The Washington Post Aiding and Abetting Obama Cover-Up of IRS Targeting of Tea Party*, CONSERVATIVE HQ (Aug. 4, 2013), <http://www.conservativehq.com/article/14065-washington-post-aiding-and-abetting-obama-cover-irs-targeting-tea-party>.

admonished themselves for their complicity in scandalmongering.¹⁵ The evidence thus far indicates that the IRS may have been tone-deaf and feckless but was not motivated by a political agenda.

To understand why the IRS handled tax-exempt applications the way it did, it is necessary to understand the legal and factual landscape related to the applications.¹⁶ Most of the organizations at issue had applied for IRS recognition as *social welfare organizations*—sometimes called “(c)(4)s” in reference to the statute that provides their tax exemption.¹⁷ To qualify as a (c)(4), an organization must be operated “exclusively for the promotion of social welfare,”¹⁸ defined to be “the common good and general welfare of the people of the community” and “bringing about civic betterments and social improvements.”¹⁹ The Sierra Club, AARP, and the NRA are well-

¹⁵ See Alex Seitz-Wald, *How the Media Outrageously Blew the IRS Scandal: A Full Accounting*, SALON (July 8, 2013, 6:00 PM), http://www.salon.com/2013/07/08/how_the_media_outrageously_blew_the_irs_scandal_a_full_accounting/.

¹⁶ This Essay provides a brief overview of certain aspects of an extremely complex area of tax law. For detailed expositions of the law related to social welfare organizations and political activity, see GREG COLVIN ET AL., COMMENTS OF THE INDIVIDUAL MEMBERS OF THE EXEMPT ORGANIZATION COMMITTEE’S TASK FORCE ON SECTION 501(C)(4) AND POLITICS (2004), available at http://www.americanbar.org/content/dam/aba/migrated/tax/pubpolicy/2004/040525_exo.authcheckdam.pdf [hereinafter TASK FORCE COMMENTS]; Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United*, 10 ELECTION L.J. 363, 375–93 (2011) [hereinafter Aprill, *Regulating Political Speech*]; see also JOINT COMM. ON TAXATION, REPORT OF INVESTIGATIONS OF ALLEGATIONS RELATING TO INTERNAL REVENUE SERVICE HANDLING OF TAX-EXEMPT ORGANIZATION MATTERS 6, 122–62 (2000) [hereinafter JCT REPORT] (finding “no credible evidence that the IRS delayed or accelerated issuance of determination letters to tax-exempt organizations based on the nature of the organization’s perceived views.”). For additional legal analysis of tax-exempt organizations and political activity, see generally Ellen P. Aprill, *Why the IRS Should Want to Develop Rules Regarding Charities and Politics*, 62 CASE W. RES. L. REV. 643 (2012) [hereinafter Aprill, *Rules*]; Laura Brown Chisolm, *Politics and Charity: A Proposal for Peaceful Coexistence*, 58 GEO. WASH. L. REV. 308 (1990); Laura B. Chisolm, *Exempt Organization Advocacy: Matching the Rules to the Rationales*, 63 IND. L.J. 201 (1988); Roger Colinvaux, *Regulation of Political Organizations and the Red Herring of Tax Exempt Status*, 59 NAT’L TAX J. 531 (2006); Brian Galle, *Charities in Politics: A Reappraisal*, 54 WM. & MARY L. REV. 1561 (2013); Miriam Galston, *Lobbying and the Public Interest: Rethinking the Internal Revenue Code’s Treatment of Legislative Activities*, 71 TEX. L. REV. 1269 (1993); Oliver A. Houck, *On the Limits of Charity: Lobbying, Litigation, and Electoral Politics by Charitable Organizations Under the Internal Revenue Code and Related Laws*, 69 BROOK. L. REV. 1 (2003); Jill S. Manny, *Nonprofit Legislative Speech: Aligning Policy, Law, and Reality*, 62 CASE W. RES. L. REV. 757 (2012); Lloyd Hitoshi Mayer, *Charities and Lobbying: Institutional Rights in the Wake of Citizens United*, 10 ELECTION L.J. 407 (2011); Donald B. Tobin, *Political Campaigning by Churches and Charities: Hazardous for 501(c)(3)s, Dangerous for Democracy*, 95 GEO. L.J. 1313 (2007).

¹⁷ 26 U.S.C. § 501(c)(4) (2006). Some of the organizations applied for exempt status as charities under § 501(c)(3). See TIGTA REPORT, *supra* note 5, at 12 n.31.

¹⁸ 26 U.S.C. § 501(c)(4) (2006).

¹⁹ 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i) (2013). There is also an exclusionary component to the definition of social welfare—it does not include promoting the private benefit of the group’s members or others. However, this requirement seems of little consequence in determining limits on the political activity of social welfare organizations.

known examples of social welfare organizations.

As a condition to their tax-exempt status, social welfare organizations must also comply with certain limits on their political activity. Social welfare organizations are distinct from the more familiar category of tax-exempt organizations referred to as *charities*, which are organized and operated for religious, charitable, educational, and other purposes.²⁰ Charities are restricted in the amount they may *lobby*—that is, to seek to influence legislation.²¹ Furthermore, they are prohibited from engaging in *campaign intervention*—that is, participation or intervention in any political campaign for public office.²² In contrast, social welfare organizations are free to lobby without limitation provided such lobbying furthers the exempt purpose of promoting social welfare.²³ In addition, unlike charities, social welfare organizations are not prohibited from engaging in campaign intervention.²⁴ Rather, they are permitted to engage in campaign intervention as long as it is not their primary activity.²⁵

Exactly how much campaign intervention a social welfare organization can engage in without crossing the “primary activity” threshold (and thus jeopardizing its tax-exempt status) is unclear. As Mariam Galston summarizes, the courts might interpret the threshold to mean “larger than de minimis but not too big”—somewhere in the range of ten to fifteen percent of an organization’s expenditures or

See TASK FORCE COMMENTS, *supra* note 16, at 20–23.

²⁰ 26 U.S.C. § 501(c)(3) (2006). These organizations are further categorized as either public charities or private foundations, depending on the type of activities they engage in or their sources of support. See *id.* § 509(a). The deductibility of contributions to private foundations is more limited than for contributions to public charities. Furthermore, private foundations are required to spend a certain amount of their income currently and are taxed on certain types of income.

In addition to the different restrictions on political activity discussed here, another important difference between charities and social welfare organizations is that donations to charities are eligible for the charitable deduction while donations to social welfare organizations are not. See *id.* § 170(c)(2).

²¹ Under 26 U.S.C. § 501(c)(3), lobbying must be “no substantial part” of a charity’s activities. The specific limitations on lobbying depend on whether the charity is a public charity or a private foundation, and whether it makes an election to be subject to special rules under I.R.C. § 501(h) establishing a safe harbor for lobbying amounts. See JCT REPORT, *supra* note 16, at 135–53.

²² See 26 U.S.C. § 501(c)(3) (2006).

²³ See Aprill, *Regulating Political Speech*, *supra* note 16, at 375–77.

²⁴ The statute requires that a social welfare organization be operated “exclusively” for the promotion of social welfare. See 26 U.S.C. § 501(c)(4) (2006). However, the IRS has interpreted this requirement to mean that the social welfare organization must be “primarily engaged” in the promotion of social welfare. See 26 C.F.R. § 1.501(c)(4)-1(a)(2)(i) (2013).

A social welfare organization is subject to tax on its investment income to the extent that it engages in campaign intervention. See 26 U.S.C. § 527(f) (2006).

²⁵ See *id.*

activities.²⁶ However, as Galston also notes, the IRS seems to take a more liberal position, although it has never set out a specific percentage, and some practitioners argue that the threshold is as high as forty or even forty-nine percent.²⁷ The only certainty is that there is no bright line demarcating an acceptable percentage of campaign intervention activity.²⁸

Even more problematic than the indeterminate “primary activity” threshold is the subjective facts-and-circumstances test used to determine whether an activity constitutes campaign intervention as opposed to lobbying or some other permitted activity.²⁹ The very same activity might be considered campaign intervention or not, depending on a multitude of factors.³⁰ For example, whether a candidate forum constitutes campaign intervention might depend on factors including whether multiple candidates for the same office are invited; whether the organization indicates support or opposition to one or more candidates; whether political fundraising occurs; whether a nonpartisan panel formulates the questions posed to the candidates; whether the topics cover a broad range of issues that are of interest to the public; and whether candidates are asked to agree or disagree with positions, platforms, agendas, or statements of the organization.³¹

Historically, most social welfare organizations did not aggressively push the limits on the campaign intervention activity described above. Some groups, such as the Sierra Club or the NRA, might engage quite actively in lobbying but would limit their campaign intervention activities.³² However, the majority of social

²⁶ See Mariam Galston, *Vision Service Plan v. U.S.: Implications for Campaign Activities of 501(c)(4)s*, 53 EXEMPT ORG. TAX REV. 165, 167, 167 n.20 (2006).

²⁷ See *id.* at 167–69; see also TASK FORCE COMMENTS, *supra* note 16, at 39–43 (analyzing the extent of political activity permissible for § 501(c)(4) organizations).

²⁸ In addition, even if there were a fixed numeric percentage for “primary activity,” determining what proportion of an organization’s activities consist of campaign intervention would still involve complex allocation questions depending on how much time or money, directly or indirectly, the organization spends on campaign intervention versus other activities. See TASK FORCE COMMENTS, *supra* note 16, at 45–50; *cf.* 26 C.F.R. § 56.4911-3 (2013) (setting out allocation rules for purposes of the tax on excessive lobbying expenditures by public charities).

²⁹ See TASK FORCE COMMENTS, *supra* note 16, at 23–38; Aprill, *Regulating Political Speech*, *supra* note 16, at 381–87.

³⁰ See Gregory L. Colvin, *Political Tax Law After Citizens United: A Tie for Reform*, 66 EXEMPT ORG. TAX REV. 71, 72 (2010).

³¹ See Rev. Rul. 2007-41, 2007-1 C.B. 1421, 1423; Rev. Rul. 2004-6, 2004-1 C.B. 328; see also Colvin, *supra* note 30, at 72–79 (illustrating through a hypothetical the intractability of the multifactor test and proposing reforms that would increase certainty and provide safe harbors).

³² Both the Sierra Club and the NRA have affiliated 527 organizations that engage in campaign intervention. For discussion of 527 organizations, see *infra* notes 34–42 and accompanying text. Like many well-known tax-exempt organizations, they also have

welfare organizations—groups like The Lumberjack World Championships Foundation and The Ballroom Latin and Swing Dance Association—engaged in little or no political activity of any kind.³³ Instead, if a group planned to engage primarily in campaign intervention, it would organize as a *527 organization* (named after the section of the tax law that governs such groups).

By definition, 527 organizations—typically including PACs, candidates' campaign committees, and political parties—engage primarily in campaign intervention.³⁴ During the 1990s, coincident with the rise of super wealthy individual political donors, 527 organizations became popular as vehicles for unregulated campaign money.³⁵ They were dubbed “stealth PACs” because the tax law did not require them to disclose the identity of donors, nor were they subject to campaign finance law reporting and donor disclosure requirements.³⁶ One of the most notorious of these 527

affiliated public charities. This “hybrid structure” enables them to solicit tax-deductible contributions to their public charities, engage freely in lobbying through their social welfare organizations, and participate in campaign intervention through their 527 arms.

³³ See Jeff Krehely & Kendall Golladay, *The Scope and Activities of 501(c)(4) Social Welfare Organizations: Fact Versus Fantasy* 14, 16 (2001) (unpublished manuscript) (on file with author) (finding that in 2000, only 818 of approximately 22,000 social welfare organizations listed advocacy as one of their three primary activities in their filings with the IRS).

³⁴ See 26 U.S.C. § 527 (2006). Technically, these groups are defined primarily to engage in activities related to their “exempt function,” which is defined as “influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors.” *Id.* § 527(e)(2). Most experts think that “exempt function” is very similar to but not co-terminous with “campaign intervention.” See TASK FORCE COMMENTS, *supra* note 16, at 24–35; Aprill, *Regulating Political Speech*, *supra* note 16, at 382–84.

527 organizations are partially tax-exempt: contributions they receive are exempt from tax, but other income, such as investment income, is taxed. See JCT REPORT, *supra* note 16, at 123.

³⁵ For a detailed account of stealth PACs and their role in electoral campaign finance, see Richard Briffault, *The 527 Problem . . . and the Buckley Problem*, 73 GEO. WASH. L. REV. 949 (2005).

³⁶ Briffault sums up the unique “best of all worlds” status of 527 organizations as follows:

In the late 1990s, politically active interest groups flourished in the regulatory gap between the Internal Revenue Code and FECA. These organizations were able to argue successfully both that their issue advocacy and other electoral activities were sufficiently election-related to qualify for section 527 tax-exempt treatment, but not sufficiently election-related to trigger FECA's disclosure requirements and other rules. These politically active organizations could enjoy tax-exempt status, sidestep FECA's limitations and requirements, avoid section 501(c)'s primary purpose cap on campaign activities, and benefit from the gift tax exemption for donations to 527 organizations, to boot. Section 527 quickly became the campaign finance vehicle of choice for many interest groups in the late 1990s.

See *id.* at 958–59.

organizations was Republicans for Clean Air, which ran political ads against John McCain in the Republican primary leading up to the 2000 presidential election. George W. Bush won both the Republican primary and the general election. It was later revealed that Republicans for Clean Air was funded by the Texas billionaire brothers Sam and Charles Wyly, major Bush supporters.³⁷

The “best of all worlds” status of 527 organizations came to an end in 2000, when Congress amended the tax law to require 527 organizations to disclose their donors.³⁸ Legal experts predicted that political strategists would shift their activities from 527 organizations to social welfare organizations, which are not required to disclose their donors.³⁹ However, it was not until the Supreme Court’s 2010 decision in *Citizens United*⁴⁰ that the number of groups applying for exempt status as social welfare organizations increased dramatically.⁴¹ *Citizens United* freed corporations and unions to spend unlimited amounts in elections and prompted the formation of politically active social welfare organizations such as Crossroads GPS, which was founded by Karl Rove in 2010 and spent at least \$70 million in the 2012 election cycle.⁴²

³⁷ See Donald B. Tobin, *Anonymous Speech and Section 527 of the Internal Revenue Code*, 37 GA. L. REV. 611, 614–16 (2003).

³⁸ See Act to Amend the Internal Revenue Code of 1986 to Require 527 Organizations to Disclose Their Political Activities, Pub. L. No. 106-230, 114 Stat. 477 (2000), amended by Pub. L. No. 107-276, 116 Stat. 1929 (2002). As the code has been amended, 527 organizations with anticipated receipts of less than \$25,000 per year, organizations that already file with the Federal Election Commission (FEC), and organizations engaged solely in state and local electoral activity that report and disclose their contributions and expenditures under a qualifying state law regime need not file with the IRS. See *id.* at 2 (codified at 26 U.S.C. § 527(e)(5), (j)(5)(C) (2006)).

³⁹ Frances R. Hill, *Probing the Limits of Section 527 to Design a New Campaign Vehicle*, 86 TAX NOTES 387, 400 (2000); Daniel L. Simmons, *An Essay on Federal Income Taxation and Campaign Finance Reform*, 54 FLA. L. REV. 1, 81 (2002).

It was thought that the benefits of donor anonymity for social welfare organizations would be offset by the possibility that donations would be subject to the gift tax. In contrast, donations to 527 organizations are explicitly not exempt from the gift tax. See Hill, *supra* note 39, at 389–90. However, this concern has been laid to rest at least for the time being, as the IRS has announced that it will not try to impose the gift tax on donations made to social welfare organizations. See Ellen P. Aprill, *Once and Future Gift Taxation of Transfers to Section 501(c)(4) Organizations: Current Law, Constitutional Issues, and Policy Considerations*, 15 N.Y.U. J. LEGIS. & PUB. POL’Y 289, 292 (2012).

⁴⁰ *Citizens United v. FEC*, 558 U.S. 310 (2010).

⁴¹ See Aprill, *Regulating Political Speech*, *supra* note 16, at 363–64. The number of social welfare organization applications received by the IRS nearly doubled from the year 2010 to 2012, from 1,735 to 3,357. See TIGTA REPORT, *supra* note 5, at 3.

⁴² It reported expenditures of nearly \$71 million during the 2012 federal election cycle. See *Crossroads GPS Independent Expenditures*, OPENSECRETS.ORG, <http://www.opensecrets.org/pacs/indexpend.php?cycle=2012&cmte=C90011719> (last visited Sept. 1, 2013). One estimate, however, puts Crossroad GPS’s total spending at over \$100 million. See Jacob Fention, *Karl Rove’s Super PAC Breaks \$100 Million in Spending*, SUNLIGHT FOUNDATION REPORTING GROUP (Nov. 6, 2012, 11:02 AM), <http://reporting.sunlightfoundation.com/2012/karl-roves-super-pac-passes-100-million->

In light of this background, it becomes clear that the IRS faced a challenging and delicate task in determining whether applicants qualified as social welfare organizations. It had to ascertain whether and to what extent the applicant engaged in campaign intervention, as defined under a subjective, multifactor inquiry that required detailed information about the nature and circumstances of the applicant's activities. With limited personnel and thousands of applications to process,⁴³ the IRS made the ill-advised decision to use words such as "Tea Party" and "Patriot" (and also, as has come to light, words such as "Occupy" and "Progressive"⁴⁴) to identify groups that were likely to be politically active and whose applications would then be subject to heightened scrutiny.⁴⁵

The IRS's ineptitude added credibility to the allegations of unfair targeting: confusion and lack of clarity within the IRS about how to handle the applications—perhaps compounded by a fear of incurring the wrath of powerful members of Congress⁴⁶—led to inconsistent treatment, undue delays, and intrusive information requests.⁴⁷ Bureaucratic bungling⁴⁸ aside, however, allegations of

spending/.

⁴³ The IRS receives about 70,000 tax-exempt applications each year, several thousand of which are social welfare applications. The initial processing of all applications is handled by fewer than 200 employees in the Cincinnati office. See Internal Revenue Serv., *Questions and Answers on 501(c) Organizations*, IRS.GOV (May 15, 2013), <http://www.irs.gov/uac/Newsroom/Questions-and-Answers-on-501%28c%29-Organizations>; see also Kim Barker & Justin Elliott, *How the IRS's Nonprofit Division Got So Dysfunctional*, PROPUBLICA (May 17, 2013, 5:14 PM), <http://www.propublica.org/article/how-irs-nonprofit-division-got-so-dysfunctional> (describing dysfunction in the Cincinnati office of the IRS).

⁴⁴ See Letter from J. Russell George, *supra* note 12; Jonathan Weisman, *I.R.S. Scrutiny Went Beyond the Political*, N.Y. TIMES (July 4, 2013), http://www.nytimes.com/2013/07/05/us/politics/irs-scrutiny-went-beyond-the-political.html?pagewanted=all&_r=0.

⁴⁵ Moreover, the heightened scrutiny involved seeking information about the nature and extent of groups' political activities that, while legally necessary, seemed overly intrusive. See Donald B. Tobin, *FAQs on 501(c)(4) Social Welfare Organizations*, May 20, 2013, *available at* [http://moritzlaw.osu.edu/electionlaw/analysis/documents/FAQs%20on%20501\(c\)\(4\)%20Social%20Welfare%20Organizations%20v.6.pdf](http://moritzlaw.osu.edu/electionlaw/analysis/documents/FAQs%20on%20501(c)(4)%20Social%20Welfare%20Organizations%20v.6.pdf).

⁴⁶ Norm Ornstein describes how in 2011, the IRS floated the idea of imposing gift taxes on donors' contributions to social welfare organizations as a way to curb what Ornstein characterizes as "an obvious and in-your-face flouting of the intent of the law and even of the regulations." See Norm Ornstein, *The IRS Scandal Isn't About Taxes—It's About Disclosure*, THE ATLANTIC, (May 23, 2013, 11:17 AM), <http://www.theatlantic.com/politics/archive/2013/05/the-irs-scandal-isnt-about-taxes-its-about-disclosure/276166/>. The proposal was quickly shut down by a letter of protest from six Republican senators, including four members of the Finance Committee, which oversees the IRS. See *id.* As Ornstein sums up, "[t]hese senators have enormous power over the IRS, and the implication of the letter was clear: Go any further on this, and there will be hell to pay." See *id.*

⁴⁷ See TIGTA REPORT, *supra* note 5, at 5–21; NATIONAL TAXPAYER ADVOCATE, SPECIAL REPORT TO CONGRESS: POLITICAL ACTIVITY AND THE RIGHTS OF APPLICANTS FOR

political bias may have been inevitable given the political minefield the IRS was tasked to navigate. Indeed, in 2000, one Treasury official predicted exactly this result:

Imposition of such a burden on the IRS would be an administrative nightmare for the agency. The IRS does not have adequate resources to take on this difficult and politically sensitive role of regularly monitoring campaign activities and disclosure reports. The IRS would inevitably be subject to claims of discrimination and political bias for actions taken or not taken.⁴⁹

Allegations of political bias and targeting by the IRS must be taken seriously. They have a long history and sometimes prove true.⁵⁰ Today, given the increased polarization of U.S. politics, they are even more likely to occur. In this particular case, it was predictable and possibly unavoidable that the IRS would be accused of political bias. At the same time, however, politically fraught situations such as this one virtually guarantee by their very nature that the IRS will be highly scrutinized and that potential targets will receive adequate protection. As the Tea Party controversy shows, when political bias is alleged, hearings will be held, investigations will be launched, reports will be written, and no stone will go unturned to discover any hint that the IRS may have abused its discretion.

That is not to say there are not serious problems with the way in which the IRS exercised its discretion in this case. The IRS's central function—to raise revenue to finance the government—is of vital importance. Allegations of bias and revelations of bureaucratic incompetence threaten the legitimacy of the IRS, which undermines the entire tax system. Furthermore, the IRS may be chilled from enforcing the tax laws for fear of political fallout, while at the same

TAX-EXEMPT STATUS 14–22 (2013) [hereinafter SPECIAL REPORT]; WERFEL, *supra* note 10, at 9–10.

⁴⁸ See *supra* note 14 and accompanying text.

⁴⁹ Memorandum from Steve Arkin, U.S. Treasury Office of Tax Policy (June 13, 2000) (on file with author), reproduced in Sam Stein, *IRS Scandal Predicted in June 2000 Treasury Memo*, HUFFINGTON POST (June 21, 2013, 12:37 PM), http://www.huffingtonpost.com/2013/06/20/irs-scandal-treasury-steve-atkins_n_3473110.html; see also Alex Seitz-Wald, *How Boehner Helped Create IRS Scandal 13 Years Ago*, SALON (July 11, 2013, 4:05 PM), http://www.salon.com/2013/07/11/boehner_inadvertently_helped_start_irs_scandal_13_years_ago (discussing how H.R. 4762 put the IRS in the position of having to determine “whether nonprofit advocacy groups would be required to disclose their donors because too much of their activities crossed the theoretical line between ‘issues advocacy’ and ‘political campaign intervention’”).

⁵⁰ See JOHN A. ANDREW III, *THE POWER TO DESTROY: THE POLITICAL USES OF THE IRS FROM KENNEDY TO NIXON* (2002).

The allegations of political bias in the current controversy are quite similar to those leveled against the IRS during the Clinton Administration. At the direction of Congress, the Joint Committee on Taxation investigated the charges and concluded there was no basis for the accusations. See JCT REPORT, *supra* note 16.

time, some taxpayers may be emboldened to flout the law because they perceive the IRS to be set back on its heels.⁵¹ In addition, controversies such as this provide ammunition to antitax lawmakers in their quest to defund the IRS and further impair compliance and collection efforts.⁵²

If we wish to minimize the risk of such costly mistakes in the future, what insights can we gain from the Tea Party controversy about strategies to improve the exercise of IRS discretion? Peter Shuck enumerates a range of techniques for controlling administrative discretion: (1) *political* controls through presidential and congressional review, (2) *processual* controls through public participation, (3) *legal* controls through review by courts and specialized tribunals, (4) *managerial* controls through professional and managerial norms, and (5) *programmatic* controls through market oriented discipline.⁵³ This taxonomy helps to characterize some of the policy prescriptions and directions for future research that emerge from the Tea Party controversy.

Political controls worked perhaps too well in the case of the Tea Party controversy. Congress exerted control over the IRS in a variety of ways: it created TIGTA to provide independent oversight of the IRS.⁵⁴ TIGTA conducted its investigation at the request of Members of Congress.⁵⁵ Upon publication of the TIGTA report, at least five congressional committees held hearings and conducted further investigations. These overlapping congressional control mechanisms ensured that allegations of IRS discretionary abuse would be thoroughly investigated. However, the costs of these control mechanisms—the reputational damage to the IRS and the collateral consequences—are too high. We would do better to avoid giving the IRS responsibilities that are apt to be politically controversial, even if the risk of abuse is low and even if other agencies are not necessarily

⁵¹ Anecdotes are circulating in the practice community that taxpayers want to take more aggressive positions in the wake of the controversy, reasoning that the IRS will be too cowed to object.

⁵² See Charles S. Clark, *House Appropriators Slash IRS Budget in Wake of Scandal*, GOV'T EXEC. (July 9, 2013), <http://www.govexec.com/management/2013/07/house-appropriators-slash-irs-budget-wake-scandal/66311/> (describing a proposal to cut the IRS budget by twenty-four percent and withhold ten percent of enforcement spending unless the IRS implements the recommendations of the TIGTA REPORT).

⁵³ See PETER H. SCHUCK, *FOUNDATIONS OF ADMINISTRATIVE LAW* 176–82 (2d ed. 2013).

⁵⁴ TIGTA was established under the IRS Restructuring and Reform Act of 1998. Its mission is to “provide independent oversight of IRS activities,” “prevent[ing] and detect[ing] . . . fraud, waste, and abuse within the IRS and related entities.” TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, <http://www.treasury.gov/tigta/index.shtml> (last visited Sept. 1, 2013).

⁵⁵ See TIGTA REPORT, *supra* note 5, at 3.

better equipped to carry out these responsibilities.⁵⁶ Of course, it is impossible for the IRS to avoid controversy entirely, and for some, the very existence of a tax system seems to have become a political flash point. However, Congress ought to be more cognizant that these controversies impose great costs on the tax system. Unfortunately, this warning probably comes too late for the implementation of the Affordable Care Act, in which the IRS will play a major role. Building on the Tea Party controversy, political attacks on the IRS and its role in the new healthcare law have already begun.⁵⁷

Processual techniques such as public participation can be a valuable control mechanism, although the IRS has been reluctant to embrace them.⁵⁸ Theoretically, the IRS could submit informal guidelines, such as those for processing tax-exempt applications, to an APA-like notice-and-comment process.⁵⁹ While this would achieve a heightened level of transparency and accountability, this level of process might be too cumbersome or otherwise inappropriate in some cases. In these cases, the IRS should consider intermediate levels of process. For example, the TIGTA Report made a recommendation⁶⁰—which the IRS accepted—that the IRS set forth its processes for handling tax-exempt applications in the Internal

⁵⁶ Specifically with respect to the regulation of political activity involved in the Tea Party controversy, Lloyd Mayer concludes that but for the risk of regulatory capture, the FEC is better equipped than the IRS to carry out the regulatory task. See Lloyd H. Mayer, *The Much Maligned 527 and Institutional Choice*, 87 B.U. L. REV. 625, 683 (2007). Mayer observes that the IRS is less susceptible to political capture than the FEC in part because the IRS is protective of its reputation as a neutral and fair tax collector. See *id.* at 675. My argument is that reputational damage to the IRS is extremely costly and ought to be avoided wherever possible. This prescription complements the literature criticizing tax expenditures—social and economic spending programs implemented through the tax law—and calling for tax reforms that focus the IRS on its core function. See, e.g., Linda Sugin, *Tax Expenditures, Reform, and Distributive Justice*, 3 COLUM. J. TAX L. 1, 3 (2011) (“Serious proposals for tax reform are on the table, and they share a simple, fundamental approach to reshaping the law: strip the Code of the myriad special deductions, credits and exclusions that allow individuals and corporations to reduce their tax liability.”).

⁵⁷ See, e.g., Sandy Fitzgerald, *Gingrich: IRS Targeting Scandal Raises Issues About Obamacare*, NEWSMAX (May 13, 2013, 10:57 AM), <http://www.newsmax.com/newsfront/gingrich-irs-obamacare-tea/2013/05/13/id/504157>; Robert Pear, *House Votes to Bar I.R.S. Action on Health Law*, N.Y. TIMES (Aug. 2, 2013), http://www.nytimes.com/2013/08/03/us/politics/house-votes-to-bar-irs-from-enforcing-health-law.html?_r=0 (“‘The I.R.S. has been abusing its power by targeting and punishing American citizens for their political beliefs,’ said Representative Eric Cantor of Virginia, the majority leader. . . . ‘The last thing we should do is to allow the I.R.S. to play such a central role in our health care.’”).

⁵⁸ See Hickman, *Coloring*, *supra* note 3; Rimma Tsvasman, *No More Excuses: A Case for the IRS’s Full Compliance with the Administrative Procedure Act*, 76 BROOK. L. REV. 837, 843–49 (2011).

⁵⁹ Such guidelines are not rules governed by the APA. See Hickman, *Unpacking*, *supra* note 3, at 492–508.

⁶⁰ See TIGTA REPORT, *supra* note 5, at 10–11.

Revenue Manual, an internal compilation of IRS guidelines and practices that is publicly available.⁶¹

Legal control of administrative discretion, through judicial review, is a subject of much uncertainty and complexity when it comes to the IRS,⁶² a full exploration of which is beyond the scope of this Essay. One central legal issue in the Tea Party controversy is whether the Treasury regulation defining a social welfare organization as one “*primarily engaged*” in the promotion of social welfare impermissibly modifies the statutory requirement that such an organization be operated “*exclusively*” for the promotion of social welfare. Some commentators have asserted that the IRS interpretation of the statute is illegal and that the Tea Party controversy would not have arisen had the IRS acted within the boundaries of the law.⁶³ Legal scholars take a more nuanced view of the IRS interpretation,⁶⁴ but the validity of the regulation has never been challenged in court. If judicial review is supposed to provide a safeguard against the possibility of interpretive abuse, questions to be explored include why it failed to operate as a check on administrative discretion in this case, to what extent it succeeds or fails in other contexts, and whether it can be improved as a control mechanism for administrative discretion.⁶⁵

Managerial control of administrative discretion—through the development of professional and managerial norms—was clearly deficient in the Tea Party controversy. The enhancement of such norms holds much promise as a means to achieve better administration. To the extent feasible, the IRS should be methodical

⁶¹ See generally Archie W. Parnell, Jr., *The Internal Revenue Manual: Its Utility and Legal Effect*, 32 TAX L. 687 (1979) (describing and analyzing the Internal Revenue Manual).

⁶² See Hickman, *Unpacking*, *supra* note 3; Leandra Lederman, *What Do Courts Have to Do With It?: The Judiciary's Role in Making Federal Tax Law*, 65 NAT'L TAX J. 889, 906–10 (2012).

⁶³ See Evan Puschak, *O'Donnell: The Real IRS Scandal Happened in 1959*, MSNBC.COM (May 13, 2013, 10:47 PM), <http://tv.msnbc.com/2013/05/13/odonnell-the-real-irs-scandal-happened-in-1959/>; see also Ornstein, *supra* note 46 (arguing that the IRS reacted to strong political pressure from Republican lawmakers).

⁶⁴ See Galston, *supra* note 26, at 166–69; Ellen P. Aprill, *The IRS's Tea Party Tax Row: How 'Exclusively' Became 'Primarily'*, PACIFIC STANDARD (June 7, 2013), <http://www.psmag.com/politics/the-irss-tea-party-tax-row-how-exclusively-became-primarily-59451/>.

⁶⁵ Scholars have identified and analyzed a handful of other cases where Treasury regulations may have exceeded statutory authority. See Samuel D. Brunson, *Watching the Watchers: Preventing I.R.S. Abuse of the Tax System*, 14 FLA. TAX REV. 223 (2013); Lederman, *supra* note 62, at 906–13; Gregg D. Polsky, *Can Treasury Overrule the Supreme Court?* 84 B.U. L. REV. 185 (2004); J. Mark Ramseyer & Eric B. Rasmusen, *Can the Treasury Exempt Its Own Companies from Tax? The \$45 Billion GM NOL Carryforward*, 1 CATO PAPERS ON PUB. POL'Y 1 (2011); Sunil Sheno, *Undoing Undue Favors: Providing Competitors with Standing to Challenge Favorable IRS Actions*, 43 U. MICH. J.L. REFORM 531 (2010); Lawrence Zelenak, *Custom and the Rule of Law in the Administration of the Income Tax*, 62 DUKE L.J. 829 (2012).

and transparent about its internal processes when the exercise of discretion is involved. The Taxpayer Advocate Service has made valuable suggestions along these lines—recommending, for example, that the IRS consult with taxpayers and other stakeholders in formulating procedures and post them on the Internet.⁶⁶

Another managerial technique that the IRS should explore is to adopt “best practices” in its rulemaking that will operate to limit its discretion. In the Tea Party controversy, the IRS interpreted the law in a manner that gave it expansive discretion,⁶⁷ which in turn led to bureaucratic failures in the exercise of that discretion. One way the IRS could avoid such bureaucratic failures would be to “self-police,” that is, consciously interpret and implement the law in ways that limit, rather than expand, its discretion. With respect to the specific laws implicated in the Tea Party controversy, some experts have made exactly this recommendation, proposing that the subjective, multifactor approach of the IRS be replaced by a more “bright-line” test.⁶⁸ An important avenue for future research to explore is whether recommendations of this type—for example, to use bright-line rules rather than subjective or multifactor standards—should be adopted more broadly by the IRS as professional and managerial norms.⁶⁹

The Tea Party controversy inflicted needless damage on the IRS and distracted lawmakers from their more important responsibilities. A cynic might say that the only good it did was to sell a lot of newspapers. However, the controversy also presents an opportunity to explore strategies to ensure that the IRS exercises its power wisely, thereby enhancing its integrity and legitimacy. This Essay begins that

⁶⁶ See SPECIAL REPORT, *supra* note 47, at 18–21 (2013). But see Brunson, *supra* note 65, at 245–54 (arguing that the Taxpayer Advocate Service and the IRS Oversight Committee cannot adequately protect against IRS abuse of discretion); Heather B. Conoboy, *A Wrong Step in the Right Direction: The National Taxpayer Advocate and the 1998 IRS Restructuring and Reform Act*, 41 WM. & MARY L. REV. 1401, 1409–16 (2000) (arguing that the Taxpayer Advocate Service’s mission is too focused on remedying specific instances of abuse of discretion and does not address systemic problems at the IRS).

⁶⁷ The IRS expanded its discretion in two ways. First, it interpreted the statute’s requirement that groups be operated “exclusively” to promote social welfare to mean that they must be “primarily engaged” in the promotion of social welfare. Second, it interpreted “campaign intervention” to be determined by subjective, multi-factor tests. See *supra* notes 25–31 and accompanying text.

⁶⁸ See TASK FORCE COMMENTS, *supra* note 16, at 43–51; Aprill, *Rules*, *supra* note 16, at 682–83; The Bright Line Project: Clarifying IRS Rules on Political Intervention, *Drafting Committee Explanation* (Interim Draft July 12, 2013), <http://www.citizen.org/documents/BLP-clarifying-irs-rules-on-political-intervention.pdf>.

The IRS has adopted a bright-line approach in the aftermath of the Tea Party controversy, proposing a safe harbor for organizations whose campaign intervention activity is less than forty percent and whose social welfare activity exceeds sixty percent. See WERFEL, *supra* note 10, at 25.

⁶⁹ See generally Colin S. Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65 (1983) (describing and analyzing regulatory “precision”).

exploration in the hopes that a better and stronger IRS will emerge.